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STATE LAND DEPARTMENT OF THE STATE OF ARIZONA

BEFORE THE BOARD OF APPEALS

IN THE MATTER OF APPEAL OF
APPRAISAL OF APPLICATION TO
PURCHASE GROUNDWATER NO. 21-102152
IN THE AMOUNT OF \$85 PER ACRE-FOOT,
WITH A MINIMUM ANNUAL REMOVAL OF
80 ACRE-FEET FOR A TOTAL MINIMUM
ANNUAL ROYALTY OF \$6,800 FOR A TERM
OF TEN YEARS ON STATE LAND
DESCRIBED AS:

SECTION 17, TOWNSHIP 13 NORTH,
RANGE 9 WEST, YAVAPAI COUNTY,
ARIZONA A.B. NO. 997

IN THE MATTER OF APPEAL OF
APPRAISAL OF APPLICATION TO
PURCHASE GROUNDWATER NO. 21-102153
IN THE AMOUNT OF \$85 PER ACRE-FOOT,
WITH A MINIMUM ANNUAL REMOVAL OF
80 ACRE-FEET FOR A TOTAL MINIMUM
ANNUAL ROYALTY OF \$6,800 FOR A TERM
OF TEN YEARS ON STATE LAND
DESCRIBED AS:

SECTION 29, TOWNSHIP 14.5 NORTH,
RANGE 8 WEST, YAVAPAI COUNTY,
ARIZONA A.B. NO. 998

FINDINGS OF FACT,
CONCLUSIONS OF LAW,
AND ORDER
for A.B. Nos. 997 through
1001

IN THE MATTER OF APPEAL OF
APPRAISAL OF APPLICATION TO
PURCHASE GROUNDWATER NO. 21-102154
IN THE AMOUNT OF \$85 PER ACRE-FOOT,
WITH A MINIMUM ANNUAL REMOVAL OF
80 ACRE-FEET FOR A TOTAL MINIMUM
ANNUAL ROYALTY OF \$6,800 FOR A TERM
OF TEN YEARS ON STATE LAND
DESCRIBED AS:

SECTION 1, TOWNSHIP 15 NORTH,
RANGE 9 WEST, YAVAPAI COUNTY,
ARIZONA A.B. NO. 999

IN THE MATTER OF APPEAL OF
APPRAISAL OF APPLICATION TO
PURCHASE GROUNDWATER NO. 21-102155
IN THE AMOUNT OF \$85 PER ACRE-FOOT,
WITH A MINIMUM ANNUAL REMOVAL OF
80 ACRE-FEET FOR A TOTAL MINIMUM
ANNUAL ROYALTY OF \$6,800 FOR A TERM
OF TEN YEARS ON STATE LAND
DESCRIBED AS:

SECTION 11, TOWNSHIP 15 NORTH,
RANGE 9 WEST, YAVAPAI COUNTY,
ARIZONA A.B. NO. 1000

IN THE MATTER OF APPEAL OF
APPRAISAL OF APPLICATION TO
PURCHASE GROUNDWATER NO. 21-102156
IN THE AMOUNT OF \$85 PER ACRE-FOOT,
WITH A MINIMUM ANNUAL REMOVAL OF
80 ACRE-FEET FOR A TOTAL MINIMUM
ANNUAL ROYALTY OF \$6,800 FOR A TERM
OF TEN YEARS ON STATE LAND
DESCRIBED AS:

SECTION 24, TOWNSHIP 15 NORTH,
RANGE 9 WEST, YAVAPAI COUNTY,
ARIZONA A.B. NO. 1001

APPELLANT: CYPRUS BAGDAD COPPER
CORP.

Pursuant to proper notice and A.R.S. § 37-215, the above captioned matters were consolidated and came before the Board of Appeals on December 18, 1997 in Room 321, 1616 West Adams, Phoenix, Arizona. The issue on appeal was whether the appraisals for the five applications to purchase groundwater, captioned above, reflected the true value of the water.

The State Land Department ("Department") was present and represented by Karen E. Baerst, Assistant Attorney General. The Appellant was present and represented by Attorney Lauren J. Caster. Terri Skladany, Assistant Attorney General from the Solicitor General's Office, was present and represented the Board.

The Board read and considered its file and the evidence presented in this matter. Based on this record, the Board makes the following Findings of Fact and Conclusions of Law:

Findings of Fact

1. The Appellant's Applications to Purchase Groundwater Nos. 21-102152, 21-102154, and 21-102155 are intended to secure the right to purchase groundwater to supplement the municipal water supply of the Town of Bagdad, Arizona. Application No. 21-102153 is intended to secure the right to purchase groundwater to supplement the water supply to a trailer park located approximately four miles north of the Town of Bagdad. Application No. 21-102156 is intended to secure the right to purchase groundwater to supplement the industrial water supply of Appellant's mining operation near the Town of Bagdad.

2. None of the wells from which groundwater would be withdrawn pursuant to Appellant's Applications Nos. 21-102152 through 21-102156 is located within an Active Management Area. The groundwater to be withdrawn pursuant to these Applications would not be used in an Active Management Area. The relative locations of the wells to each other and to the Town of Bagdad are shown on the Appellant's Exhibit No. 1 submitted prior to the hearing.

3. The production capacities of the wells from which water would be withdrawn pursuant to Applications Nos. 21-102153 through 21-102156 have declined over time from their initial estimated production capacities. This is believed to be due to the fact that they are drilled into fracture zones in rock formations rather than into large alluvial aquifers. Pumping from these wells normally must be suspended from time to time to allow the fracture zones to recharge with groundwater.

4. The average depth of the wells from which groundwater would be withdrawn pursuant to Applications Nos. 21-102153 through 21-102156 is 478 feet. The depth of the well from which groundwater would be withdrawn pursuant to Application No. 21-102152 is 473 feet.

5. The Appellant's Application to Purchase Groundwater No. 21-102152 seeks to purchase groundwater from one well located at the Skunk Canyon (also known as "Skunk Wash") well site. That well site is located in Section 17, Township 13 North, Range 9 West.

6. The Department recognized several notable features related to the Skunk Canyon application: (i) the well is located approximately eight miles southwest of the central

business district of Bagdad, (ii) the Applicant intended to use water extracted from this well to contribute to Bagdad's back-up water supply, (iii) before the water can be used, the successful bidder would have to construct a pipeline to transport the water from the well site to the points of treatment and use, and (iv) the application requested the right to purchase a minimum of 80 acre feet of groundwater per year for a ten-year term.

7. The Department appraised the market value of the water from the Skunk Canyon location at \$85.00 per acre foot.

8. The Appellant's appraisal concluded that the value of the water from the Skunk Canyon location to be \$35.00 per acre foot. The factors that the Appellant's appraisal considered were: (i) the excellent location of the well near Highway 97, (ii) the six mile distance from the well to a power source and the eight mile distance from the well to the point of use, (iii) the improvements needed to use this water would cost one million dollars, (iv) the fact that the point of withdrawal and place of use are outside an Active Management Area, and (v) due to the relative remoteness of this water source from other potential water uses, the lack of market demand for water from this water source.

9. The Appellant's Application to Purchase Groundwater No. 21-102153 seeks the right to purchase groundwater from two wells located at the Sycamore well site. That well site is located in Section 29, Township 14½ North, Range 8 West.

10. The Department recognized several notable features related to the Sycamore application: (i) the wells are located approximately five miles southeast of Bagdad, (ii) the Applicant will use the groundwater for domestic, municipal, and industrial purposes, (iii) the water is transported to the points of treatment and use by delivery pipelines, and (iv) the

application requested the right to purchase a minimum of 80 acre feet of groundwater per year for a ten-year term.

11. The Department appraised the market value of the water from the Sycamore location at \$85.00 per acre foot.

12. The Appellant's appraisal concluded that the value of the water from the Sycamore location to be \$65.00 per acre foot. The factors that Appellant's appraisal considered were: (i) the excellent location of the well site and (ii) the requirement of a short power and delivery system, (iii) the fact that the points of withdrawal and place of use are outside an Active Management Area, and (iv) due to the relative remoteness of these water sources from other potential water uses, the lack of market demand for water from these water sources.

13. The Appellant's Application to Purchase Groundwater No. 21-102154 seeks the right to purchase groundwater from one well located at the Contreras well site. That well site is located in Section 1, Township 15 North, Range 9 West.

14. The Department recognized several notable features related to the Contreras application: (i) the well is located approximately seven miles northeast of Bagdad, (ii) the Applicant uses the water for domestic, municipal, and industrial purposes, (iii) the water is transported to the points of treatment and use by a delivery pipeline, and (iv) the application requested the right to purchase a minimum of 80 acre feet of groundwater per year for a ten-year term.

15. The Department appraised the market value of the water from the Contreras location at \$85.00 per acre foot.

16. The Appellant's appraisal concluded that the value of the water from the Contreras location to be \$35.00 per acre foot. The factors that appellant's appraisal considered were: (i) the poor access to the well and (ii) the need for approximately eleven miles of power and delivery system to the point of use, (iii) the fact that the point of withdrawal and place of use are outside an Active Management Area, and (iv) due to the relative remoteness of this water source from other potential water uses, the lack of market demand for water from this water source.

17. The Appellant's Application to Purchase Groundwater No. 21-102155 seeks the right to purchase groundwater from one well located at the Urie well site. That well site is located in Section 11, Township 15 North, Range 9 West.

18. The Department recognized several notable features related to the Urie application: (i) the well is located approximately five miles north of Bagdad, (ii) the Applicant uses the water for domestic, municipal, and industrial purposes, (iii) the water is transported to the points of treatment and use by a delivery pipeline, and (iv) the application requested the right to purchase a minimum of 80 acre feet of groundwater per year for a ten-year term.

19. The Department appraised the market value of the water from the Urie location at \$85.00 per acre foot.

20. The Appellant's appraisal concluded that the value of the water from the Urie location to be \$35.00 per acre foot. The factors that Appellant's appraisal considered were: (i) the poor access to the well and (ii) the need for approximately seven miles of power and delivery systems to the point of use, (iii) the fact that the withdrawal and place of use are

outside an Active Management Area, and (iv) due to the relative remoteness of this water source from other potential water uses, the lack of market demand for water from this water source.

21. The Appellant's application to Purchase Groundwater No. 21-102156 seeks the right to purchase groundwater from two wells located at the Warm Springs well site. That well site is located in Section 24, Township 15 North, Range 9 West. Water from these wells is transported by means of a pipeline system that is wholly separate from the system carrying water from wells from which groundwater would be withdrawn under Applications Nos. 21-102153 through 21-102155.

22. The Department recognized several notable features related to the Warm Springs application: (i) the well is located approximately five miles north of Bagdad, (ii) the Applicant uses the water for domestic, municipal, and industrial purposes, (iii) the water is transported to the point of use by a delivery pipeline, and (iv) the application requested the right to purchase a minimum of 80 acre feet of groundwater per year for a ten-year term.

23. The Department appraised the market value of the water from the Warm Springs location at \$85.00 per acre foot.

24. The Appellant's appraisal concluded that the value of the water from the Warm Springs location to be \$30.00 per acre foot. The factors that Appellant's appraisal considered were: (i) the poor access to the wells, (ii) the need for approximately five miles of power and delivery systems to the point of use, (iii) the water contains radiochemical contaminants in concentrations that exceed drinking water standards, (iv) the limitation that the water can be used only for industrial purposes, (v) the fact that the points of withdrawal

and place of use are outside an Active Management Area, and (vi) due to the relative remoteness of these water sources from other potential water uses, the lack of market demand for water from these water sources.

25. When the Department learned of the existence of radiochemical contaminants at Warm Springs, it amended the appraisal of the market value of the water from these wells to \$75.00 per acre foot.

26. The Appellant's geologist, Dr. Phil Blacet testified that the Appellant has been looking for water to supply Bagdad for the last 40 years and that the water from the State land offers a good back-up water supply to Bagdad's approximately 2,000 residents. Dr. Blacet noted that the water from the wells on State land provides approximately 15% of the City's water needs and, without this back-up system, the community would be at risk if the main water system became inoperable.

27. The Appellant has leased the State land on which the wells are located since the 1960's. Prior to the most recent appraisals, the Appellant paid \$35.00 per acre foot for water extracted at each of the wells.

28. In arriving at its appraisal for each of the applications, the Department evaluated nine pending or actual sales or leases of water in California, Oklahoma, Colorado, and Arizona. The transactions occurred between 1992 and the present and had a value range from a low of \$65.00 per acre foot to a high of \$135.00 per acre foot. Likewise, the amount of water sold or leased ranged from less than one acre foot to 200,000 acre feet and some of the transactions encompassed surface water sales, rather than groundwater sales.

29. The Department adjusted the comparables and assigned them weight according

to their similarity to the wells at issue.

30. The Department did not evaluate the location differences among the wells because it determined that location was not a true adjustment factor. The Department concentrated its focus on the value of the water. The Appellant maintained that the location of the water sources was a factor in evaluation.

31. The Department did not consider extraction costs in setting value because it viewed extraction as a cost of doing business and did not have a basis on which to estimate the extraction cost because the successful bidder and the use it would make of the water would not be known until auction. The Appellant maintained that the cost of developing and making use of the groundwater from the well sites mentioned in the Applications must be considered in determining the value of the water because those costs diminished the demand for water from those water sources, thus driving downward the value of the water to prospective buyers.

32. The parties generally agreed that in recent history competition to purchase groundwater from the Department is rare, resulting in less consideration of the market as a factor in value. The parties generally agree that the key elements to determine water value are the water's quality, quantity, and location.

33. The Appellant maintained that those prior purchases of groundwater in Active Management Areas that afforded the purchasers the right to withdraw groundwater pursuant to the Department's own Type 2 Grandfathered Groundwater Right as well as the right to purchase the groundwater itself, were of little value as comparable sales for these Applications. Absent the ability to withdraw under the Department's own Type 2 Right, the successful bidder would have had to acquire its own Type 2 Right in order to be able to

withdraw groundwater from State Trust Lands in those instances. In the Appellant's view, the ability to rely on the Department's own Type 2 Right undoubtedly conferred a benefit on the purchaser in those transactions. The purchaser under these Applications, in contrast, may withdraw groundwater from State Trust Lands without securing any grandfathered groundwater right or groundwater withdrawal permit of any kind. The Department did not regard this distinction as a relevant factor in determining the market value estimate of groundwater under these Applications. Similarly, the Appellant maintained that the fact that the points of withdrawal and the places of use of the groundwater being purchased under these Applications are outside an Active Management Area makes the groundwater to be purchased pursuant to these Applications worth less than groundwater purchased in transactions involving pumping within an Active Management Area. The Department disagreed.

34. Between December of 1996 and November of 1997, the Department conducted three public auction water sales of water valued and sold at \$85.00 per acre foot and two public auction water sales of water valued and sold at \$90.00 per acre foot.

35. There are few true comparables on which to evaluate these applications. Therefore, the appraisals are necessarily very subjective.

Conclusions of Law

1. Section 28 of Arizona's Enabling Act, 36 U.S. Stat. 557, 568-79, Act of June 1910, requires that products of State land "shall be appraised at their true value, and no sale or disposal thereof shall be made for a consideration less than the value so ascertained." *See also* Ariz. Const. Art. 10, § 8.

2. In Arizona, water "is a thing of value directly derived from land to be considered a product of the land within the meaning of the Constitution and Enabling Act." *Farmers Investment Co. v. Pima Mining Co.*, 111 Ariz. 56, 58, 523 P.2d 487, 489 (1974).

Discussion

The standards to be applied in evaluating the true market value of the water that is the subject of these applications are: quality, location, usage, and quantity. Although the Department and the Appellant have compiled complete appraisal reports for all of the applications, the Board is concerned about the reasonableness of the appraisals in view of the standards that should be applied and the significant disparity in value between the Department's appraisals and the Appellant's appraisals. Both the Department's appraiser and the Appellant's appraiser have sound appraisal experience and have completed between 12 and 20 water appraisals. Curiously, the disparity between the Department's and Appellant's appraised values approximates 80%. Such disparity reflects the subjectivity of these evaluations. Thus, our charge is to establish a rational basis for the value of the water accounting for the economic reasonableness of each transaction, the differences in water quality and water sources, and the prior comparable sales.

The dilemma in placing great weight on the Department's 1996-97 water sales is that most purchasers have made a significant investment to develop the well sites, are in need of the water, and thus will not freely abandon the leases. Therefore, the limited Department water sales preceding the appraisals' date of value, although correctly used as comparables, should not unduly weight the value on these applications.

Therefore, the Board finds the value of water for each of the applications at issue is

as follows:

A.B. 997 (Skunk Canyon): \$50.00 per acre foot because the well adjoins a highway and therefore has a superior location.

A.B. 998 (Sycamore): \$75.00 per acre foot because it has a good location and acceptable potable water quality. Although the Department priced the water at \$85.00 per acre foot, the Board finds that the Department priced the water too high because it did not account for the difference in location with the other Department sales which the Department viewed as comparable. This location should have had a downward adjustment in value because the water was not in an AMA requiring water rights for withdrawal.

A.B. 999 (Contreras): \$65.00 per acre foot because it is not readily accessible, is the worst location, and is a significant distance from the point of use.

A.B. 1000 (Urie): \$65.00 per acre foot because of its lack of accessibility and distance from the point of use.

A.B. 1001 (Warm Springs): \$45.00 per acre foot because it is unpotable water. Although this water does not meet current standards for drinking, it has a current commercially beneficial use to the Appellant and has potential for other uses.

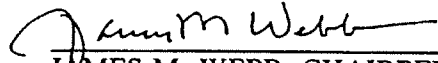
ORDER

Based on the foregoing Findings of Fact, Conclusions of Law, and Discussion, it is hereby ordered sustaining the appeals challenging the appraisals on A.B. 997 through 1001 and setting the value of the water as follows:

A.B. 997 (Skunk Canyon):	\$50.00 per acre foot
A.B. 998 (Sycamore):	\$75.00 per acre foot
A.B. 999 (Contreras):	\$65.00 per acre foot
A.B. 1000 (Urie):	\$65.00 per acre foot
A.B. 1001 (Warm Springs):	\$45.00 per acre foot

This Decision is subject to rehearing or review pursuant to A.R.S. § 41-1092.09 and A.A.C. R12-5-2315. An aggrieved party may file a motion for rehearing or review within thirty days after service of this administrative decision. The motion for rehearing or review shall be in writing and shall meet the requirements in A.A.C. R12-5-2315(C). Pursuant to A.R.S. § 41-1092.09, an aggrieved party is not required to file a motion for rehearing or review of the Board's decision in order to exhaust its administrative remedies. Judicial review of the Board's decision is subject to the time restrictions and procedures in A.R.S. § 41-1092.10.

DATED: January 20, 1998


JAMES M. WEBB, CHAIRPERSON

A copy of the foregoing was mailed on January 22, 1998
by certified mail, return receipt requested, to:

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By Carol Halty